

SIGIR Observations

OVERVIEW

2006: A YEAR OF TRANSITION IN IRAQ RECONSTRUCTION

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OVERVIEW

During the past quarter, the Special Inspector General for Iraq Reconstruction (SIGIR) continued to advance aggressive oversight of the use of U.S. funds in Iraq's reconstruction. In executing its responsibilities, SIGIR promotes the efficiency and effectiveness of the U.S. reconstruction program and ensures that taxpayer dollars are spent wisely. Moreover, SIGIR's role in Iraq's reconstruction aims to help secure the overall success of the U.S. effort and thereby honor the sacrifices of the soldiers and contractors killed or wounded.

SIGIR's most notable achievements during the past quarter were the arrests of four U.S. citizens for bribery, fraud, and theft involving Iraq reconstruction funds on contracts valued

at more than \$13 million. These arrests signal that the United States is unequivocally committed to fighting corruption and promoting accountability on all fronts in Iraq.

SIGIR's Audit and Inspections divisions continued to focus oversight on the reconstruction gap, the cost to complete reconstruction projects, the sustainability of completed projects, the effort to fight corruption in Iraq, and the persistent need to develop an effective reconstruction project database. Future audits and inspections will provide further reporting on these and other issues.

With the issuance of this Quarterly Report, SIGIR introduces the review of a new issue—transition.

2006: A YEAR OF TRANSITION IN IRAQ RECONSTRUCTION

2006 will be a year of transition for the U.S. reconstruction program in Iraq. The successful December 2005 elections launched Iraq into a new phase of its history. The first government elected under Iraq's new constitution is now forming and will soon assume responsibility for managing Iraq's economy and infrastructure. These developments will fundamentally alter the nature of the U.S./Iraq relationship on many levels, including reconstruction.

By the end of FY 2006, the United States expects to have fully obligated the Iraq Relief

and Reconstruction Fund (IRRF)¹. IRRF dollars represent only a portion of the amount estimated by the World Bank and United Nations (UN) to be necessary to restore Iraq's infrastructure, and the IRRF has provided a substantial down payment on what will be a lengthy restoration process. The progress made thus far with U.S. reconstruction funds has supplied the new Iraqi government with a significant start toward establishing an effective infrastructure and eventual prosperity.

As more and more IRRF projects are

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completed, the U.S. agencies and elements that currently manage and implement the overall U.S. reconstruction effort—including the Iraq Reconstruction Management Office (IRMO) and the U.S. Army Corps of Engineers Gulf Region Division Project and Contracting Office (GRD-PCO)²—will implement transition strategies to ensure that completed projects and related assets are turned over to the appropriate Iraqi officials who have the training and budgetary resources necessary to sustain them. As the transition process gains momentum, the U.S. reconstruction presence in Iraq will begin to shift toward foreign assistance programs managed by the Department of State (DoS) and the U.S. Agency for International Development (USAID).

Regarding the reconstruction transition, SIGIR has several concerns:

- Do all of the U.S. reconstruction implementing agencies in Iraq have strategic plans in place for transitioning their respective parts of the reconstruction program?
- Are there sufficient resources to support capacity development for national and local

government officials, operations and maintenance, infrastructure security, development of strategic cities, and private sector development?

- Have Iraqi officials sufficiently budgeted and planned for the essential maintenance of the new, U.S.-provided infrastructure?
- Is the United States prepared to sustain the reconstruction presence required to complete planned projects that may take another three or four years to complete?

SIGIR has learned that an IRMO transition team is reviewing the critical issue of funding sustainment in the near term. Additionally, the Department of Defense (DoD) and DoS have begun transition planning for their respective areas of responsibility. This quarter, USAID presented a plan for transitioning U.S. assistance from the infrastructure-focused IRRF reconstruction effort to a more traditional technical assistance strategy. Thus, there are significant signs that transition planning is being implemented. But the importance of this issue compels SIGIR to announce a new audit

CONTINUING CHALLENGES

that will review all reconstruction transition planning. SIGIR continues to follow a number of critical issues raised in earlier Quarterly Reports:

- the “reconstruction gap”
- sustainability
- cost-to-complete estimates
- anticorruption efforts in Iraq
- information systems management

The Reconstruction Gap

The SIGIR October 2005 Quarterly Report initially examined the “reconstruction gap”—the difference between what was originally planned for reconstruction in the various sectors and what will actually be delivered. This is not an alarm bell but merely an observation of a current reality: changing conditions in Iraq, including deteriorating security conditions and evolving political and economic priorities required IRRF reprogramming that altered sector funding levels and projected outcomes.

This quarter, SIGIR conducted an audit of the reconstruction gap that found that the U.S. government will not complete the number of projects anticipated by the IRRF program allocations in the November 2003 legislation. In two key sectors, the audit found these notable shortfalls:

- Of the 136 projects originally planned in the Water sector, only 49 (36%) will be completed. Most of the projects planned in sewerage, irrigation and drainage, major irrigation, and dams have been terminated. DoS reports that Iraq’s water treatment capacity will be increased only by 2.25 mil-

lion cubic meters per day.

- Of the 425 projects originally planned by CPS in the Electricity sector, only 300 (70.5%) will be completed. Of the 3,400 additional megawatts planned for the Generation sub-sector, only 2,200 megawatts will be delivered.

These shortfalls are substantially attributable to the autumn 2004 IRRF reprogramming, which reduced the allocations to the Water sector from \$4.3 billion to \$2.1 billion (down 51.2%). The Electricity sector dropped from \$5.560 billion to \$4.309 billion (down 22.5%). Allocations to certain other sectors concomitantly increased: the Private Sector Development sector grew by 420%, and the Justice, Public Safety, Infrastructure, and Civil Society sector rose by 70%.³

A number of factors combined to make these program changes necessary, the most significant being the rise of the insurgency. A new strategy that was more responsive to the new security and political situation in Iraq resulted in the reallocation of \$5.6 billion in IRRF funding. Additionally, administrative costs of the U.S. agencies using the IRRF produced approximately \$425 million in program changes. Another \$350 million is now budgeted for new sustainment activities that were not included in original planning. Finally, the following factors have also contributed to the reconstruction gap:

- inadequate or non-existent cost estimates for many projects in the original November 2003 plan

- increased costs of materials, particularly in the Oil and Gas sector, aggravated by smuggling of subsidized construction materials across Iraq's borders
- high costs of contractor security
- high costs of project delays caused by intimidation and violence
- evolving reconstruction priorities to fit the Multi-National Force-Iraq campaign plan and political requirements
- lack of oversight of reconstruction projects as they developed

Security has been a significant cost-driver. In July 2004, DoS reallocated \$1.8 billion to training and equipping Iraqi security forces and associated expenditures. Security costs for contractors have risen on average from an initial 10-12% to more than 25%, adding greatly to the costs of major construction projects. The need for this increase in security spending is demonstrated most clearly by the number of contractors kidnapped, wounded, and killed since March 2003. Intimidation of workers continues to delay projects, and the insecure environment has driven away critically needed foreign technicians in the essential services sectors.

Sustainability

SIGIR has repeatedly emphasized the importance of ensuring the sustainability of U.S. reconstruction efforts in Iraq and commended the early efforts by IRMO, PCO, and USAID officials to include sustainability costs in project budget planning. But SIGIR continues to be

concerned about the realization of sustainment goals. SIGIR believes that more resources must be allocated to sustainability. *Sustainability* is defined as the ability of a program to deliver its intended benefits for an extended period of time after major financial, managerial, and technical assistance from an external donor is terminated.

As SIGIR reported in an October 24, 2005 audit: "There is a growing recognition that the Iraqi government is not yet prepared to take over the near- or long-term management and funding of infrastructure developed through the IRRF projects." SIGIR notes that the key recommendations from the last Quarterly Report—including the creation of a Sustainment Coordinator—have been implemented. The coordinative function should continue to be a high priority for reconstruction managers in Iraq.

SIGIR audits conducted this quarter made these key sustainability recommendations:

- Create a single database of IRRF-related assets and provide it to the Iraqi government to support planning and budgeting.
- Coordinate plans and funding for the sustainment of Commander's Emergency Response Program (CERP) construction projects with DoS, IRMO, GRD-PCO, and USAID.

SIGIR inspections have also provided insight into the sustainability of projects in Iraq.

Thirteen SIGIR inspections are included in this Report, and each includes a review of

the planning for sustainment. SIGIR plans to continue using inspections as a key tool to assess the sustainability of Iraq reconstruction projects.

Cost-to-complete Estimates

Nearly a year ago, SIGIR reported that the U.S. reconstruction program did not have reliable cost-to-complete estimates for its projects. Since that time, SIGIR auditors have continually pressed for accurate cost-to-complete data. DoS confronted the issue last spring: in March 2005, a DoS team went to Baghdad to press for cost-to-complete data from agencies implementing the IRRF. Its efforts met with limited success.

The *cost to complete a project* is defined as the total estimated cost of the project less the actual cost of work performed to date. The *estimated cost of the project* is the actual direct cost, plus indirect costs or allocable costs to the contract, plus the estimate of costs (direct and indirect) for authorized work remaining. The *actual cost of work performed to date* is the cost (direct and indirect) to date of completed work packages and the completed portion of work packages begun and not yet completed.

The failure to compile and report cost-to-complete information, as required by Public Law 108-106, has made it difficult for implementing agencies to exercise effective fiscal management of IRRF dollars. This has deprived SIGIR of the financial visibility it needs to execute its oversight responsibility. Without current and accurate cost-to-complete data, management cannot determine whether

sufficient funds will be available to complete ongoing work, nor can it project the availability of funds for any new programs or projects.

During this quarter, SIGIR completed an audit to determine the adequacy of methodologies used to estimate and report the costs to complete IRRF-funded projects. The audit reviewed how cost-to-complete numbers were tracked in the Facilities and Transportation sector. SIGIR also followed up on a previous recommendation to IRMO to create a single set of unified cost-to-complete procedures. IRMO's first cost-to-complete report (October 2005) showed serious underfunding in several reconstruction sectors. The cost-to-complete report for this quarter is overdue; therefore, no observations about progress can be made.

Anticorruption Efforts in Iraq

SIGIR remains committed to intensifying U.S. efforts to promote an effective anticorruption system within the Iraqi government and commends the U.S. Mission's efforts thus far to support anticorruption institutions in Iraq. In the October 2005 Quarterly Report, SIGIR urged the Ambassador to hold an anticorruption summit, which he did in November 2005. The summit resulted in a proposal for a joint U.S.-Iraqi Anticorruption Working Group and initial agreement on the need for more training for officials from the Board of Supreme Audit, the Commission on Public Integrity, and the Inspectors General of the Iraqi ministries.

The Embassy Anticorruption Working Group previously identified several major priorities, including:

- promoting market reforms and reducing subsidies
- helping to reinforce the weak law enforcement structure
- creating a public education campaign on the corruption issue

In 2006, SIGIR will announce an audit to evaluate the progress of the U.S. anticorruption initiative.

Information Systems Management

Throughout 2005, SIGIR advised IRMO of the need for a single database for reconstruction projects in Iraq. Last quarter, IRMO mandated the creation of a consolidated database by December 2005, but this system has yet to become operational. As a result, it is difficult for SIGIR to assess the current progress of the overall project portfolio or to identify potential problems with individual projects. The reconstruction effort is too large and too important to be managed without access to accurate and complete data about the projects involved.

IRMO and the implementing agencies in Baghdad are trying to develop a common policy and process to facilitate the legal, financial, and logistical transfer of assets to the

Iraqi government. Two interagency working groups in Baghdad are addressing the problem.

SIGIR continues to develop the SIGIR Iraq Reconstruction Information System (SIRIS), but the difficulties in extracting data from U.S. government agencies in Iraq hinder SIGIR's responsiveness.

The Human Toll

The lethal environment in Iraq continues to pose extraordinary challenges to reconstruction contractors. Since reconstruction began in March 2003, 467 death claims for contractors of all nationalities have been submitted under the Defense Base Act, according to the U.S. Department of Labor. The daily situation reports of the Gulf Region Division of the U.S. Army Corps of Engineers present the full range of dangers facing those who work on reconstruction projects in Iraq. The reports routinely list kidnappings, murders, attacks, bombings, armed vandalism, and threats. The January 13, 2006 report, for example, listed a car bombing, a gunshot through a car window, armed vandalism, a threat delivered by five armed and masked men on a jobsite, and six attacks on contractors.